Internal Revenue
bulletin

Bulletin No. 2001–12
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HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 2001–13, page 898.

Fringe benefits aircraft valuation formula. The Standard Industry Fare Level (SIFL) cents-per-mile rates and terminal charges in effect for the first half of 2001 are set forth for purposes of determining the value of noncommercial flights on employer-provided aircraft under section 1.61-21(g) of the regulations.

Rev. Rul. 2001–14, page 898.

LIFO; price indexes; department stores. The January 2001 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, January 31, 2001.

T.D. 8934, page 904.

Final regulations under section 1275 of the Code determine when debt instruments, including Treasury securities, sold in a reopening are part of the same issue as an issue of previously sold debt instruments.

REG–125237–00, page 919.

Proposed regulations under section 1275 of the Code provide guidance on the treatment of annuity contracts issued by an insurance company subject to tax under subchapter L. A public hearing is scheduled for May 30, 2001.

Notice 2001–24, page 912.

The "differential earnings rate" under section 809 of the Code is tentatively determined for 2000 together with the "recomputed differential earnings rate" for 1999.

EMPLOYMENT TAX

REG–110374–00, page 915.

Proposed regulations under section 6205 of the Code provide guidance on when employers that have paid less than the correct amount of employment taxes are entitled to interest free adjustments when the underpayment is discovered during an IRS examination involving a determination by the Service that workers are employees under subtitle C or that the employer is not entitled to relief under section 530 of the Revenue Act of 1978.

ADMINISTRATIVE

T.D. 8939, page 899.

Final regulations under section 6212 of the Code define a taxpayer's last known address as the address on the taxpayer's most recently filed and properly processed federal tax return, unless the taxpayer provides clear and concise notification of a different address to the IRS. The final regulations also authorize the Commissioner to use an address obtained from the United States Postal Service National Change of Address database as a taxpayer's last known address.

REG–110659–00, page 917.

Proposed regulations address the adoption of a plan of liquidation requirement under section 332 of the Code when an association makes an entity classification election to be treated as a partnership or disregarded as an entity separate from its owner.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

Notice 2001–22, page 911.

Installment sales; changes in method of accounting. This notice provides that an accrual method taxpayer that entered into an installment sale on or after December 17, 1999, and filed a federal income tax return by April 16, 2001, reporting the sale on an accrual method has the consent of the Secretary to revoke its effective election out of the installment method. The taxpayer must file, within the applicable period of limitations, amended federal income tax returns for the taxable year in which the installment sale occurred, and for any other affected taxable year, reporting the gain on the installment method. Notice 2000–26 modified.

Notice 2001–23, page 911.

Business expenses; changes in method of accounting. This notice modifies Rev. Rul. 2001–4, 2001–3 I.R.B. 295, which holds, in part, that costs incurred by a taxpayer to perform work on its aircraft airframe as part of a heavy maintenance visit generally are deductible as ordinary and necessary business expenses under section 162 of the Code. Rev. Rul. 2001–4 is modified by extending the application of the automatic consent for change in accounting method provisions of Rev. Proc. 99–49, 1999–2 C.B. 725, to the taxpayer's first or second taxable year ending after December 21, 2000. Rev. Proc. 99–49 and Rev. Rul. 2001–4 modified.

Rev. Proc. 2001–25, page 913.

Automatic accounting method change for stated interest on short-term loans. This procedure modifies section 13.02 of the Appendix to Rev. Proc. 99–49, 1999–2 C.B. 725, 757, to allow any bank that uses the cash receipts and disbursements method of accounting to change automatically its method of accounting for stated interest on short-term loans made in the ordinary course of its business. Rev. Proc. 99–49 modified.

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the first Bulletin of the succeeding semiannual period, respectively.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 61.—Gross Income Defined

26 CFR 1.61–21: Taxation of fringe benefits.

Fringe benefits aircraft valuation formula. For purposes of section 1.61–21(g) of the regulations, relating to the rule for valuing noncommercial flights on employer-provided aircraft, the Standard Industry Fare Level (SIFL) cents-per-mile rates and terminal charges in effect for the first half of 2001 are set forth.

Rev. Rul. 2001–13

For purposes of the taxation of fringe benefits under section 61 of the Internal Revenue Code, section 1.61–21(g) of the Income Tax Regulations provides a rule for valuing noncommercial flights on employer-provided aircraft. Section 1.61–21(g)(5) provides an aircraft valuation formula to determine the value of such flights. The value of a flight is determined under the base aircraft valuation formula (also known as the Standard Industry Fare Level formula or SIFL) by multiplying the SIFL cents-per-mile rates applicable for the period during which the flight was taken by the appropriate aircraft multiple provided in section 1.61–21(g)(7) and then adding the applicable terminal charge. The SIFL cents-per-mile rates in the formula and the terminal charge are calculated by the Department of Transportation and are reviewed semi-annually.

The following chart sets forth the terminal charges and SIFL mileage rates:

Period During Which the Flight Is Taken	*Terminal Charge*	*SIFL Mileage Rates*
1/1/01 - 6/30/01	$35.84	Up to 500 miles = $.1961 per mile 501-1500 miles = $.1495 per mile Over 1500 miles = $.1437 per mile

DRAFTING INFORMATION

The principle author of this revenue ruling is Kathleen Edmondson of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding this revenue ruling, contact Ms. Edmondson at (202) 622-6040 (not a toll-free call).

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446–1: General rule for methods of accounting.

The revenue procedure, which modifies section 13.02 of the Appendix to Rev. Proc. 99–49, allows any bank that uses the cash receipts and disbursements method of accounting to change automatically its method of accounting for stated interest on short-term loans made in the ordinary course of its business. See Rev. Proc. 2001–25, page 913.

Section 472.—Last-in, First-out Inventories

26 CFR 1.472–1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The January 2001 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, January 31, 2001.

Rev. Rul. 2001–14

The following Department Store Inventory Price Indexes for January 2001 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, January 31, 2001.

The Department Store Inventory Price Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups - soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100, unless otherwise noted)

Groups	Jan. 2000	Jan. 2001	Percent Change from Jan. 2000 to Jan. 2001[1]
1. Piece Goods	493.8	490.8	-0.6
2. Domestics and Draperies	622.0	614.6	-1.2
3. Women's and Children's Shoes	613.3	628.8	2.5

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE
INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS—Continued
(January 1941 = 100, unless otherwise noted)

Groups	Jan. 2000	Jan. 2001	Percent Change from Jan. 2000 to Jan. 2001[1]
4. Men's Shoes	887.2	886.8	0.0
5. Infants' Wear	650.8	609.2	-6.4
6. Women's Underwear	571.4	556.3	-2.6
7. Women's Hosiery	327.6	343.8	4.9
8. Women's and Girls' Accessories	530.3	526.9	-0.6
9. Women's Outerwear and Girls' Wear	369.1	369.7	0.2
10. Men's Clothing	612.9	586.1	-4.4
11. Men's Furnishings	618.0	603.2	-2.4
12. Boys' Clothing and Furnishings	497.1	484.6	-2.5
13. Jewelry	962.0	956.1	-0.6
14. Notions	764.5	784.3	2.6
15. Toilet Articles and Drugs	970.9	987.1	1.7
16. Furniture and Bedding	697.0	685.2	-1.7
17. Floor Coverings	603.2	630.1	4.5
18. Housewares	789.9	769.4	-2.6
19. Major Appliances	233.3	229.9	-1.5
20. Radio and Television	62.7	56.8	-9.4
21. Recreation and Education[2]	95.2	91.0	-4.4
22. Home Improvements[2]	129.8	127.7	-1.6
23. Auto Accessories[2]	107.6	108.7	1.0
Groups 1 - 15: Soft Goods	588.6	583.7	-0.8
Groups 16 - 20: Durable Goods	446.2	432.9	-3.0
Groups 21 - 23: Misc. Goods[2]	102.2	99.4	-2.7
Store Total[3]	535.4	527.4	-1.5

[1] Absence of a minus sign before the percentage change in this column signifies a price increase.
[2] Indexes on a January 1986=100 base.
3 The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Alan J. Tomsic of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Tomsic at (202) 622-4970 (not a toll-free call).

Section 503.—Requirements for Exemption

26 CFR 1.503(a)–1: Denial of exemption to certain organizations engaged in prohibited transactions.

T.D. 8939

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 301

Definition of Last Known Address

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations defining *last known address* in relation to the mailing of notices of deficiency and other notices, statements, and documents sent to a taxpayer's last known address. The final regulations affect taxpayers who receive notices of deficiency and other notices, statements, and documents sent to taxpayers' last known addresses.

DATES: *Effective date*: These regulations are effective January 12, 2001.

Applicability date: For dates of applicability, see §301.6212–2(d).

FOR FURTHER INFORMATION CONTACT: Charles A. Hall, (202) 622-4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Regulations on Procedure and Administration (26 CFR part 301) under section 6212(b) relating to the sufficiency of a notice of deficiency if it is mailed to the last known address of a taxpayer. This document also contains amendments to the Income Tax Regulations (26 CFR part 1) and the Regulations on Procedure and Administration (26 CFR part 301) to provide cross-references to the last known address rules under section 6212(b) in order to apply those rules to other notices, statements, and documents required to be sent to the last known address of a taxpayer.

A notice of proposed rulemaking (REG–104939–99, 1999–2 C.B. 643) was published in the **Federal Register** (64 FR 63768) on November 22, 1999. No public hearing was requested or held. Three written comments were received. After consideration of the comments, the proposed regulations are adopted as modified by this Treasury decision. The comments are discussed below.

Explanation of Revisions

Under the proposed regulations, the IRS would have accessed the United States Postal Service (USPS) National Change of Address database (NCOA database) annually to update all taxpayer address records maintained in the IRS's automated masterfile for purposes of updating the IRS's mailing list. The IRS's mailing list contains the last known address for each taxpayer. In addition, prior to mailing correspondence to any particular taxpayer from an IRS Service Center, the IRS would have accessed the NCOA database to update the taxpayer's last known address. Employees mailing correspondence from one of the district offices would have accessed an updated address by virtue of the annual update of the entire masterfile. Except in the case of certain joint filers, the annual update was scheduled to occur in May 2000, November 2000, and every November thereafter. The update based on correspondence mailed from an IRS Service Center was scheduled to begin May 2000. All steps necessary to implement the proposed regulations were not completed by May 2000. Therefore, the IRS delayed use of the NCOA database to update a taxpayer's last known address. See Announcement 2000–49 (2000–19 I.R.B. 998 (May 8, 2000)).

The procedures for updating taxpayer address records maintained in the IRS's automated masterfile are modified by these regulations. Implementing the proposed procedures for updating a taxpayer's last known address upon the mailing of correspondence from a Service Center required complicated programming that resulted in the delay in finalizing the proposed regulations. In addition, one commentator on the proposed regulations noted that the difference in treatment for Service Center mailings and district office mailings might cause confusion for taxpayers. The IRS, in conjunction with the USPS, has developed an improved system for updating taxpayer addresses that is intended to be easier to implement and operate and minimize confusion.

To gain access to the NCOA database, the IRS has become a limited licensee of the NCOA database. The NCOA database is a computerized record of changes of address maintained by the USPS. This database retains address changes for a thirty-six month period. As a limited licensee, the IRS will receive from the USPS a copy of the entire thirty-six month NCOA database. The IRS's copy of the NCOA database will be retained at the Martinsburg Computing Center (MCC) in Martinsburg, West Virginia. Additionally, the IRS will receive weekly updates to the NCOA database. The updates will contain the most recent changes of address submitted to the USPS. The IRS will update its copy of the full NCOA database with the most recent changes of address in the weekly update.

Beginning in January 2001, the IRS will access the NCOA database to update taxpayer address records maintained in the IRS's automated masterfile for purposes of updating the IRS's mailing list. The IRS plans to undertake two different procedures in order to assure the most comprehensive update of taxpayer addresses.

First, the IRS will compare taxpayer addresses in IRS's records to the most recent changes of address contained in the weekly updates to the NCOA database received from the USPS. To accomplish this, the IRS will use the USPS's FASTCheck system. The FASTCheck System works by comparing key elements of existing taxpayer address information maintained in IRS records to an extract of the same elements from the weekly updates to the NCOA. The key address elements used by IRS to detect possible matches include primary house number, secondary number, secondary designator, and nine digit zip code. If there is a match between the key address elements from IRS records and the key address elements from the weekly update to the NCOA database, the IRS will then compare the taxpayer's complete address information in IRS records to the full NCOA database to determine if there is a change of address for a taxpayer. If the taxpayer's name and last known address in IRS records match the taxpayer's name and old mailing address contained in the NCOA database, the new address in the NCOA database is the taxpayer's last known address, unless the IRS is given clear and concise notification of a different address. A match will only be made if the taxpayer's name in IRS records is the same, within certain tolerances, as is found in the NCOA database. There may be a delay of up to two to three weeks from the date a taxpayer notifies the USPS that his or her change of address is effective and the time the new address is posted to the IRS's automated masterfile.

In addition, the IRS plans to annually compare all taxpayer address records maintained in the IRS's automated masterfile with the full thirty-six month NCOA database for purposes of updating the IRS's mailing list. The IRS will begin comparing all taxpayer address records with the full NCOA database for the first time in January 2001. If the taxpayer's name and last known address in IRS records match the taxpayer's name and old mailing address contained in the NCOA database, the new address in the NCOA database is the taxpayer's last known address, unless the IRS is given clear and concise notification of a different address. As with the weekly updates, the names must be the same, within certain tolerances, in both the IRS's records and the NCOA database. Matching all taxpayer address records to the full NCOA database will take several months. The next annual update will be completed by September 30, 2002, and every September 30th thereafter if the IRS determines that subsequent annual updates are necessary in addition to the weekly updates.

For taxpayers who file joint income tax returns under section 6013, the IRS's automated masterfile is currently only able to retain one address. Beginning with the processing of tax year 2000 joint income tax returns, the IRS's automated masterfile will be able to retain a second address. Therefore, if the NCOA database contains change of address information for only one spouse from a joint return, the rules of this regulation will not apply to notices, statements, and other documents mailed before the processing of the

taxpayers' tax year 2000 joint income tax return.

Summary of Comments

Commentators also suggested that these regulations refer to section 6672(b)(1) and section 4103. Because section 6672(b)(1) requires that the IRS mail notices to the taxpayer's last known address, a cross-reference under §301.6672–1 has been added to these regulations. However, because section 4103 does not require the IRS to mail notices to the taxpayer's last known address, no cross-reference is necessary.

A third commentator suggested that the IRS coordinate these regulations with Rev. Proc. 90–18 (1990–1 C.B. 491). Rev. Proc. 90–18 will be updated to incorporate changes made by these final regulations and to provide rules for oral notification of a change of address, additional tax forms from which taxpayer addresses will be updated, and additional Internal Revenue Code sections that require a notice be sent to a taxpayer's last known address.

The commentator also asked what is the most recently filed return for purposes of §301.6212–2(a) of the regulations, i.e., whether different returns filed by the same taxpayer will update the taxpayer's last known address. The rules provided in these regulations do not in any way alter the existing rules for updating a taxpayer's last known address from a filed return. Section 5.01 of Rev. Proc. 90–18 provides which returns will update a taxpayer's last known address under a social security number or an employer identification number. Therefore, an amended return filed on a Form 1040X with a different address from that which appeared on the taxpayer's previously filed Form 1040 will update the taxpayer's last known address of record with the IRS. However, a Form 941 filed by a Schedule C business would not update the address for the taxpayer's individual income tax account as the Form 941 is filed with an employer identification number and the individual income tax account is associated with the taxpayer's social security number.

Finally, as mentioned above, the commentator noted that accessing the NCOA database for IRS Service Center mailings but not for district office mailings might cause confusion for taxpayers. As the procedures for updating taxpayer addresses are modified by these final regulations, there is no longer any difference between Service Center and other field or area office mailings.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Charles A. Hall of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. In §1.468A–5, paragraph (c)(1)(ii) is amended by adding a sentence at the end of the paragraph to read as follows:

§1.468A–5 Nuclear decommissioning fund qualification requirements; prohibitions against self-dealing; disqualification of nuclear decommissioning fund; termination of fund upon substantial completion of decommissioning.

* * * * *

(c) * * *

(1) * * *

(ii) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter.

* * * * *

Par. 3. In §1.503(a)–1, paragraph (c) concluding text is amended by adding a sentence at the end of the paragraph to read as follows:

§1.503(a)–1 Denial of exemption to certain organizations engaged in prohibited transactions.

* * * * *

(c) * * *

* * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter.

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Par. 4. In §1.547–2, paragraph (b)(1)(v) is amended by adding a sentence after the third sentence of the paragraph to read as follows:

§1.547–2 Requirements for deficiency dividends.

* * * * *

(b) * * *

(1) * * *

(v) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter. * * *

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Par. 5. In §1.856–6, paragraph (g)(5) is amended by adding a sentence after the first sentence of the paragraph to read as follows:

§1.856–6 Foreclosure property.

* * * * *

(g) * * *

(5) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter. * * *

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Par. 6. In §1.860–2, paragraph (b)(1)(ii) is amended by adding a sentence after the fourth sentence of the paragraph to read as follows:

§1.860–2 Requirements for deficiency dividends.

* * * * *

(b) * * *

(1) * * *

(ii) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter. * * *
* * * * *

Par. 7. In §1.963–6, paragraph (c)(5) is amended by adding a sentence after the second sentence of the paragraph to read as follows:

§1.963–6 Deficiency distribution.

* * * * *

(c) * * *

(5) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter. * * *
* * * * *

Par. 8. In §1.992–3, paragraph (c)(3)(iv) is amended by adding a sentence after the third sentence of the paragraph to read as follows:

§1.992–3 Deficiency distributions to meet qualification requirements.

* * * * *

(c) * * *

(3) * * *

(iv) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter. * * *
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Par. 9. In §1.6081–2, paragraph (f) is amended by adding a sentence at the end of the paragraph to read as follows:

§1.6081–2 Automatic extension of time to file partnership return of income.

* * * * *

(f) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter.
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Par. 10. In §1.6081–3, paragraph (d) is amended by adding a sentence at the end of the paragraph to read as follows:

§1.6081–3 Automatic extension of time for filing corporation income tax returns.

* * * * *

(d) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter.
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Par. 11. In §1.6081–4, paragraph (c) is amended by adding a sentence at the end of the paragraph to read as follows:

§1.6081–4 Automatic extension of time for filing individual income tax returns.

* * * * *

(c) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter.
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Par. 12. In §1.6081–6, paragraph (d) is amended by adding a sentence at the end of the paragraph to read as follows:

§1.6081–6 Automatic extension of time to file trust income tax return.

* * * * *

(d) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter.
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Par. 13. In §1.6081–7, paragraph (d) is amended by adding a sentence at the end of the paragraph to read as follows:

§1.6081–7 Automatic extension of time to file Real Estate Mortgage Investment Conduit (REMIC) income tax return.

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(d) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter.
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PART 301—PROCEDURE AND ADMINISTRATION

Par. 14. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 15. In §301.6110–4, paragraph (c)(3) is amended by adding a sentence at the end of the paragraph to read as follows:

§301.6110–4 Communications from third parties.

* * * * *

(c) * * *

(3) * * * For further guidance regarding the definition of last known address, see §301.6212–2.
* * * * *

Par. 16. In §301.6110–5, paragraph (b)(4) is amended by adding a sentence at the end of the paragraph to read as follows:

§301.6110–5 Notice and time requirements; actions to restrain disclosure; actions to obtain additional disclosure.

* * * * *

(b) * * *

(4) * * * For further guidance regarding the definition of last known address, see §301.6212–2.
* * * * *

Par. 17. In §301.6110–6, paragraph (b)(2)(v) is amended by adding a sentence at the end of the paragraph to read as follows:

§301.6110–6 Written determinations issued in response to requests submitted before November 1, 1976.

* * * * *

(b) * * *

(2) * * *

(v) * * * For further guidance regarding the definition of last known address, see §301.6212–2.
* * * * *

Par. 18. Section 301.6212–2 is added to read as follows:

§301.6212–2 Definition of last known address.

(a) *General rule.* Except as provided in paragraph (b)(2) of this section, a taxpayer's last known address is the address that appears on the taxpayer's most recently filed and properly processed Federal tax return, unless the Internal Revenue Service (IRS) is given clear and concise notification of a different address. Further information on what constitutes clear and concise notification of a different address and a properly processed Federal tax return can be found in Rev. Proc. 90–18 (1990–1 C.B. 491) or in procedures subsequently prescribed by the Commissioner.

(b) *Address obtained from third party*—(1) *In general.* Except as provided in paragraph (b)(2) of this section, change of address information that a taxpayer provides to a third party, such as a payor or another government agency, is not clear and concise notification of a different address for purposes of determining a last known address under this section.

(2) *Exception for address obtained from the United States Postal Service*—(i) *Updating taxpayer addresses.* The IRS will update taxpayer addresses maintained in IRS records by referring to data accumulated and maintained in the United States Postal Service (USPS) National Change of Address database that retains

change of address information for thirty-six months (NCOA database). Except as provided in paragraph (b)(2)(ii) of this section, if the taxpayer's name and last known address in IRS records match the taxpayer's name and old mailing address contained in the NCOA database, the new address in the NCOA database is the taxpayer's last known address, unless the IRS is given clear and concise notification of a different address.

(ii) *Duration of address obtained from NCOA database*. The address obtained from the NCOA database under paragraph (b)(2)(i) of this section is the taxpayer's last known address until one of the following events occurs—

(A) The taxpayer files and the IRS properly processes a Federal tax return with an address different from the address obtained from the NCOA database; or

(B) The taxpayer provides the Internal Revenue Service with clear and concise notification of a change of address, as defined in procedures prescribed by the Commissioner, that is different from the address obtained from the NCOA database.

(3) *Examples*. The following examples illustrate the rules of paragraph (b)(2) of this section:

Example 1. (i) A is an unmarried taxpayer. The address on A's 1999 Form 1040, *U.S. Individual Income Tax Return*, filed on April 14, 2000, and 2000 Form 1040 filed on April 13, 2001, is 1234 Anyplace Street, Anytown, USA 43210. On May 15, 2001, A informs the USPS of a new permanent address (9876 Newplace Street, Newtown, USA 12345) using the USPS Form 3575, "Official Mail Forwarding Change of Address Form." The change of address is included in the weekly update of the USPS NCOA database. On May 29, 2001, A's address maintained in IRS records is changed to 9876 Newplace Street, Newtown, USA 12345.

(ii) In June 2001 the IRS determines a deficiency for A's 1999 tax year and prepares to issue a notice of deficiency. The IRS obtains A's address for the notice of deficiency from IRS records. On June 15, 2001, the Internal Revenue Service mails the notice of deficiency to A at 9876 Newplace Street, Newtown, USA 12345. For purposes of section 6212(b), the notice of deficiency mailed on June 15, 2001, is mailed to A's last known address.

Example 2. (i) The facts are the same as in *Example 1*, except that instead of determining a deficiency for A's 1999 tax year in June 2001, the IRS determines a deficiency for A's 1999 tax year in May 2001.

(ii) On May 21, 2001, the IRS prepares a notice of deficiency for A and obtains A's address from IRS records. Because A did not inform the USPS of the change of address in sufficient time for the IRS to process and post the new address in Internal Revenue Service's records by May 21, 2001, the notice of deficiency is mailed to 1234 Anyplace Street, Anytown, USA 43210. For purposes of section 6212(b), the notice of deficiency mailed on May 21, 2001, is mailed to A's last known address.

Example 3. (i) C and D are married taxpayers. The address on C and D's 2000 Form 1040, *U.S. Individual Income Tax Return*, filed on April 13, 2001, and 2001 Form 1040 filed on April 15, 2002, is 2468 Spring Street, Little City, USA 97531. On August 15, 2002, D informs the USPS of a new permanent address (8642 Peachtree Street, Big City, USA 13579) using the USPS Form 3575, "Official Mail Forwarding Change of Address Form." The change of address is included in the weekly update of the USPS NCOA database. On August 29, 2002, D's address maintained in IRS records is changed to 8642 Peachtree Street, Big City, USA 13579.

(ii) In October 2002 the IRS determines a deficiency for C and D's 2000 tax year and prepares to issue a notice of deficiency. The Internal Revenue Service obtains C's address and D's address for the notice of deficiency from IRS records. On October 15, 2002, the IRS mails a copy of the notice of deficiency to C at 2468 Spring Street, Little City, USA 97531, and to D at 8642 Peachtree Street, Big City, USA 13579. For purposes of section 6212(b), the notices of deficiency mailed on October 15, 2002, are mailed to C and D's respective last known addresses.

(c) *Last known address for all notices, statements, and documents*. The rules in paragraphs (a) and (b) of this section apply for purposes of determining whether all notices, statements, or other documents are mailed to a taxpayer's last known address whenever the term *last known address* is used in the Internal Revenue Code or the regulations thereunder.

(d) *Effective Date*—(1) *In general*. Except as provided in paragraph (d)(2) of this section, this section is effective on January 29, 2001.

(2) *Individual moves in the case of joint filers*. In the case of taxpayers who file joint returns under section 6013, if the NCOA database contains change of address information for only one spouse, paragraphs (b)(2) and (3) of this section will not apply to notices, statements, and other documents mailed before the processing of the taxpayers' 2000 joint return.

Par. 19. In §301.6303–1, paragraph (a) is amended by adding a sentence at the end of the paragraph to read as follows:

§301.6303–1 Notice and demand for tax.

* * * * *

(a) * * * For further guidance regarding the definition of last known address, see §301.6212–2.

* * * * *

Par. 20. In §301.6305–1, paragraph (b)(2)(ii) is revised to read as follows:

§301.6305–1 Assessment and collection of certain liability.

* * * * *

(b) * * *

(2) * * *

(ii) The name, social security number, and last known address of the individual owing the assessed amount. For further guidance regarding the definition of last known address, see §301.6212–2;

* * * * *

Par. 21. In §301.6320–1T, paragraph (a)(1) is amended by adding a sentence at the end of the paragraph to read as follows:

§301.6320–1T Notice and opportunity for hearing upon filing of notice of Federal tax lien (temporary).

(a) * * * (1) * * * For further guidance regarding the definition of last known address, see §301.6212–2.

* * * * *

Par. 22. In §301.6325–1, paragraph (f)(2)(ii)(*a*) is revised to read as follows:

§301.6325–1 Release of lien or discharge of property.

* * * * *

(f) * * *

(2) * * *

(ii) * * *

(*a*) Mailing notice of the revocation to the taxpayer at his last known address (see §301.6212–2 for further guidance regarding the definition of last known address); and

* * * * *

Par. 23. In §301.6330–1T, paragraph (a)(1) is amended by adding a sentence at the end of the paragraph to read as follows:

§301.6330–1T Notice and opportunity for hearing prior to levy (temporary).

(a) * * * (1) * * * For further guidance regarding the definition of last known address, see §301.6212–2.

* * * * *

Par. 24. In §301.6331–2, paragraph (a)(1) is amended by adding a sentence after the second sentence of the paragraph to read as follows:

§301.6331–2 Procedures and restrictions on levies.

(a) * * * (1) * * * For further guidance regarding the definition of last known address, see §301.6212–2. * * *
* * * * *

Par. 25. Section 301.6332–2 is amended as follows:

1. Paragraphs (b)(1) introductory text, (b)(1)(i), and (b)(1)(ii) are redesignated as paragraphs (b)(1)(i) introductory text, (b)(1)(i)(A), and (b)(1)(i)(B), respectively.

2. In newly designated paragraph (b)(1)(i)(B), the text beginning with the second sentence is redesignated as paragraph (b)(1)(ii).

3. Newly designated paragraph (b)(1)(ii) is amended by adding a sentence after the second sentence of the paragraph.

The addition reads as follows:

§301.6332–2 Surrender of property subject to levy in the case of life insurance and endowment contracts.

* * * * *

(b) * * * (1) *In general.*

(ii) * * * For further guidance regarding the definition of last known address, see §301.6212–2. * * *
* * * * *

Par. 26. In §301.6335–1, paragraph (b)(1) is amended by adding a sentence after the third sentence of the paragraph to read as follows:

§301.6335–1 Sale of seized property.

* * * * *

(b) * * * (1) * * * For further guidance regarding the definition of last known address, see §301.6212–2. * * *
* * * * *

Par. 27. In §301.6503(c)–1, paragraph (a) is amended by adding a sentence at the end of the paragraph to read as follows:

§301.6503(c)–1 Suspension of running of period of limitation; location of property outside the United States or removal of property from the United States; taxpayer outside of United States.

(a) * * * For further guidance regarding the definition of last known address, see §301.6212–2.
* * * * *

Par. 28. Section 301.6672–1 is amended by adding a sentence at the end of the section to read as follows:

§301.6672–1 Failure to collect and pay over tax, or attempt to evade or defeat tax.

* * * For further guidance regarding the determination of the proper address for mailing the notice required under section 6672(b)(1), see §301.6212–2.

Par. 29. In §301.6903–1, paragraph (c) is amended by adding a sentence after the first sentence of the paragraph to read as follows:

§301.6903–1 Notice of fiduciary relationship.

* * * * *

(c) * * * For further guidance regarding the definition of last known address, see §301.6212–2. * * *
* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved December 11, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 11, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 12, 2001, 66 F.R. 2817)

Section 1275.— Other Definitions and Special Rules

26 CFR 1.1275–2: Special rules relating to debt instruments.

T.D. 8934

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Reopenings of Treasury Securities and Other Debt Instruments; Original Issue Discount

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the federal income tax treatment of debt instruments issued in certain reopenings. The final regulations provide guidance to holders and issuers of these debt instruments .

DATES: *Effective Date*: These regulations are effective March 13, 2001.

Applicability Dates: For dates of applicability, see §§1.163–7(f), 1.1275–1(f), 1.1275–2(d), and 1.1275–2(k)(5).

FOR FURTHER INFORMATION CONTACT: William E. Blanchard, (202) 622-3950 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On November 5, 1999, temporary regulations were published in the **Federal Register** (64 FR 60342) that revised the rules for when a reopening of Treasury securities is a qualified reopening. The temporary regulations eliminated the acute, protracted shortage requirement that was in §1.1275–2(d). See §1.1275–2T(d) of the temporary Income Tax Regulations. As a result, additional Treasury securities issued in a reopening are part of the same issue as the original Treasury securities if (1) the additional Treasury securities have the same terms as the original Treasury securities, and (2) the additional Treasury securities are issued not more than one year after the original Treasury securities were first issued to the public.

On November 5, 1999, proposed regulations (REG–115932–99, 1999-2 C.B. 583) also were published in the **Federal Register** (64 FR 60395) that, for the first time, provided rules for reopenings of debt instruments other than Treasury securities. See §1.1275–2(k) of the proposed Income Tax Regulations.

Although a public hearing on the proposed regulations was held on March 22, 2000, no one testified at the hearing. Eight comment letters, however, were received on the proposed regulations. The proposed regulations, with certain changes to respond to the comments, are adopted as final regulations.

Explanation of Provisions

Reopenings

A. *General description*

In certain circumstances, an issuer would like to reopen an existing issue of debt instruments (that is, sell additional amounts of debt instruments with terms

that are identical to the terms of the original debt instruments and with the same CUSIP number and tax characteristics as the original debt instruments). In most cases, the purpose of the reopening is to create a large, liquid issue of debt instruments. However, during periods of rising market interest rates, the original issue discount (OID) provisions of the Code can effectively prohibit reopenings, especially if the additional debt instruments are not considered part of the same issue as the original debt instruments.

If the debt instruments sold in the reopening are considered part of the original issue, they have OID only to the extent the debt instruments in the original issue have OID. Thus, if the original debt instruments were issued without OID, the subsequently sold debt instruments also do not have OID. In this case, any discount on the subsequently sold debt instruments generally is market discount, not OID. Conversely, if the subsequently sold debt instruments are a separate issue for tax purposes, any discount that arises as part of their issuance is OID if it equals or exceeds the OID *de minimis* amount for the debt instruments.

The holder and issuer have different consequences depending upon whether the discount is characterized as OID or market discount. For a holder, the primary difference is whether the holder has to include the discount in income on a current basis as it accrues. If it is OID, the holder must include the accruals in income currently; if it is market discount, the holder generally does not have to include discount in income until the debt instrument is disposed of or redeemed. In general, an issuer's interest deduction does not depend on whether the discount is OID or market discount. However, the issuer's reporting obligations depend on whether the discount is OID or market discount. If the subsequently sold debt instruments are part of a separate issue and if the discount is OID, the issuer (or a broker or middleman) generally is required under section 6049 to make OID information reports for these debt instruments. To comply with this reporting obligation, the issuer must be able to distinguish the subsequently sold debt instruments (which require OID information reports) from the originally sold debt instruments. As a practical matter, the only way the subsequently sold debt instruments can be distinguished is if they are assigned new CUSIP numbers. The different tax treatment and the assignment of new CUSIP numbers prevents the debt instruments from being fungible and, thereby, defeats the purpose of the reopening.

B. *Proposed regulations*

In an attempt to strike a balance between the tax policy concern about the conversion of OID into market discount and the need to have the tax rules reflect current capital market practices, the proposed regulations specified when debt instruments issued in a reopening are considered part of the same issue as the original debt instruments (a qualified reopening). (As noted above, §1.1275–2T(d) provides rules to determine when a reopening of Treasury securities is a qualified reopening.)

Under §1.1275–2(k) of the proposed regulations, a reopening of debt instruments is a qualified reopening if: (1) the original debt instruments are publicly traded; (2) the issue date of the additional debt instruments (treated as if they were a separate issue) is not more than six months after the issue date of the original debt instruments; (3) seven days before the date on which the price of the additional debt instruments is established, the yield of the original debt instruments (based on their fair market value) is not more than 107.5 percent of the yield of the original debt instruments on their issue date; and (4) the yield of the additional debt instruments (based on the sales price of the additional debt instruments) is no more than 115 percent of the yield of the original debt instruments on their issue date. For purposes of the yield tests, if the original debt instruments were issued with no more than a *de minimis* amount of OID, the coupon rate of the original debt instruments is used rather than the yield. A qualified reopening also includes a reopening of original debt instruments if the first two conditions described above are met and the additional debt instruments (treated as a separate issue) are issued with no more than a *de minimis* amount of OID. A qualified reopening, however, does not include a reopening of tax-exempt obligations or contingent payment debt instruments.

The 107.5 percent test was designed to give some relief to the reopening of relatively short-term issues (that is, issues with a remaining term of ten years or less), which tend to be the most impacted by the OID *de minimis* rules. In addition, the 107.5 percent test, which is tested seven days before the anticipated pricing date, would give the issuer an indication as to whether the reopening would be a qualified reopening. The 115 percent test was designed to prevent, in a situation in which interest rates were to move sharply upward in the period between the announcement date and the issue date, a conversion of a significant amount of OID into market discount.

C. *Final regulations*

(1) Fixed Reopening Period

Commentators suggested that the final regulations extend the one-year rule for reopenings of Treasury securities to other issuers. In support of this change, commentators stated that different rules will impede the ability of U.S. issuers to compete with foreign issuers for investors' funds and will affect the ability of non-Treasury issuers to make their dollar-denominated issues attractive alternatives to U.S. Treasury securities as benchmarks for prevailing market interest rates. They also stated that an extended period (from six to twelve months) is often required in order to aggregate sufficient debt issuances to create a large liquid issue and that many holders of reopened debt instruments are tax-indifferent parties.

If the one-year rule is not adopted in the final regulations, some commentators suggested that the final regulations provide a fixed period of less than one year in which there would be no restrictions on reopenings (for example, a period of six months for non-Treasury securities with an original maturity of less than ten years and nine months for non-Treasury securities with an original maturity of at least ten years). In addition, other commentators suggested that the final regulations extend the one-year rule to reopenings of issuers whose securities are treated as government securities for U.S. securities law purposes.

After careful consideration of these comments, the IRS and the Treasury Department have decided not to adopt these

suggestions. Congress adopted different statutory regimes for OID and market discount. The IRS and the Treasury Department believe that adopting the commentators' suggestions would not strike the appropriate balance between the statutory scheme and providing some flexibility for issuers. Additionally, the reopening of Treasury securities does not produce a potential mismatch between the issuer's interest deductions and the holder's income inclusions.

(2) Yield Test

Commentators suggested that the two-part yield test be replaced with a single yield test. According to the commentators, by the time a reopening is priced, dealers, traders, and investors have arranged their affairs in reliance on the issue coming to market, and the issuer has earmarked the proceeds for use in its business. In addition, many of the participants have arranged hedges and other transactions around the reopening. In those cases in which the second-yield test would not be met (which would be caused by unexpected market volatility), a cancelled reopening could generate lost economic costs for these capital market participants. In addition, the second test would create marketing and credibility concerns for issuers.

Most of the commentators suggested that any yield test should be applied either on the pricing date or the announcement date. According to one commentator, the yield test should be applied by an issuer on a single date that is the announcement date for the reopening transaction, provided the pricing date for the transaction occurs thereafter within a period consistent with customary commercial practice. Although customary commercial practice may vary somewhat by issuer and market, the period between the announcement date and the pricing date is usually five business days or less. The yield test should allow issuers to presume that a transaction is consistent with customary commercial practice if the period between the announcement date and the pricing date is five business days or less.

For public transactions, the commentators suggested that the announcement date can be defined as the date that the reopening transaction is publicly announced through one or more media, including a press release, a news item posted on a public messaging service such as Reuters, Telerate, or Bloomberg, or a posting on the issuer's public web site. (Because the transaction is a reopening, the payment terms of the securities to be issued will be known in advance based on the prior issue.) A test based on a public announcement date would be fairly easy to administer for both issuers and the government. Moreover, if an announced reopening transaction is not priced within a customary commercial time frame, it is likely that the transaction will be re-evaluated and subsequently re-announced on a later date that could serve as the appropriate announcement date for the yield test.

According to another commentator, each reopening should be tested on the earlier of the pricing date or the announcement date of a reopening. The term *announcement date* could be defined as the later of seven days before pricing or the date on which an issuer's intent to reopen a security is reported on the standard electronic news services used by security broker-dealers. This rule would accommodate issuers who announce and price reopenings on the same day as well as Treasury and non-Treasury issuers who announce reopenings up to 7 days before pricing.

According to a third commentator, an issuer should be permitted to satisfy any yield test by demonstrating that the test was satisfied on any one of the seven days prior to the date on which the price of the additional debt instruments was established.

Based on historical evidence, the commentators stated that the 107.5 percent test in the proposed regulations would not have been met in a number of cases in which a reopening would be economically desirable. Therefore, the commentators suggested that any yield test should be based on 115 percent of the yield rather than 107.5 percent of the yield. While a 115 percent test also would not be met in a number of cases, the commentators stated that the 115 percent figure used in the proposed regulations represents an acceptable middle ground. (However, some commentators stated that a 115 percent test would be too low to qualify many reopenings of sovereign debt issued by emerging market governments.)

In response to the comments, the final regulations adopt a single yield test to determine if the reopening is a qualified reopening. Under the final regulations, the yield test is satisfied if, on the date on which the price of the additional debt instruments is established (or, if earlier, the announcement date), the yield of the original debt instruments (based on their fair market value) is not more than 110 percent of the yield of the original debt instruments on their issue date (or, if the original debt instruments were issued with no more than a *de minimis* amount of OID, the coupon rate). For purposes of the yield test, the announcement date is the later of seven days before the date on which the price of the additional debt instruments is established or the date on which the issuer's intent to reopen a security is publicly announced through one or more media, including an announcement reported on the standard electronic news services used by security broker-dealers (for example, Reuters, Telerate, or Bloomberg). The test rate of 110 percent in the final regulations reflects a compromise between the 107.5 percent test rate in the proposed regulations and the 115 percent test rate suggested by the commentators.

(3) Six-Month Period

Some of the commentators suggested that the six-month period be extended to one year. According to the commentators, many issuers have specific funding needs that arise sporadically over the course of a year or, in the case of foreign sovereign issuers, are often fiscally constrained from reopening issues within a six-month period. Therefore, an extended period (from six to twelve months) is required in order to aggregate sufficient debt issuances to create a large, liquid issue. Because the extension of the six-month period would increase the likelihood of the conversion of OID into market discount, the final regulations do not adopt this suggestion.

(4) *De Minimis* Test

Some of the commentators suggested that the final regulations clarify the treatment of reopened debt instruments that are issued with no more than a *de minimis* amount of OID after the expiration of the six-month period (a *de facto* qualified re-

opening). According to the commentators, the proposed regulations apparently are stricter than current law in limiting a *de facto* qualified reopening to one in which the reopened securities are issued within six months after the issue date of the original debt instruments. As a result, there is uncertainty in the debt markets where none existed for these securities.

The final regulations provide that a reopening (including a reopening of Treasury securities) is a qualified reopening if the original debt instruments are publicly traded and the additional debt instruments are issued with no more than a *de minimis* amount of OID (determined without the application of §1.1275–2(k)). As a result, the *de minimis* test is no longer limited to the six-month period after the issue date of the original debt instruments.

(5) Reopenings after the Six-Month Period

Some of the commentators suggested that the final regulations allow a reopening occurring after the expiration of the fixed reopening period to be a qualified reopening if the reopening satisfies a yield test that would limit the amount of OID converted into market discount. In the experience of the commentators, as longer-term debt securities progress in age, they become less liquid as compared with shorter-term debt securities of equal remaining life. (For example, a thirty-year debt issue with five years of remaining life generally can be expected to be less liquid than an otherwise identical new five-year issue.) The ability to reopen a security throughout its life would help issuers increase the liquidity of their longer-term issues as needed to address such competitive concerns. This ability would be highly valuable to private sector and government-sponsored enterprise issuers; therefore, it would be appropriate to allow it so long as a yield test ultimately limits the amount of OID that can be converted into market discount. For example, the final regulations could permit an issuer (including the Treasury Department) to reopen a security after the fixed reopening period if a 10 percent yield-change test is met.

The final regulations do not adopt this suggestion. The IRS and the Treasury Department believe that the changes to the *de minimis* test described above provide the appropriate relief for debt instruments reopened after the six-month period.

D. *Treasury securities*

The final regulations concerning reopenings of Treasury securities are generally the same as the temporary regulations. See §1.1275–2(d)(2). In addition, under the final regulations, if a reopening of Treasury securities is not a qualified reopening under §1.1275–2(d)(2) (for example, because the reopening date is more than one year after the issue date of the original Treasury securities), the reopening is a qualified reopening under §1.1275–2(k) if the additional Treasury securities are issued with no more than a *de minimis* amount of OID (determined without the application of §1.1275–2(k)).

E. Issuer's treatment

The proposed regulations require the issuer to take into account, as an adjustment to its interest expense, any difference between the amounts paid by the holders to acquire the additional debt instruments issued in a qualified reopening and the adjusted issue price of the original debt instruments. This difference would either increase or decrease the adjusted issue prices of all of the debt instruments in the issue (both original and additional) with respect to the issuer (but not the holder). The issuer would then, as of the reopening date, recompute the yield of the debt instruments in the issue based on this aggregate adjusted issue price and the remaining payment schedule of the debt instruments. The issuer would use this recomputed yield for purposes of applying the constant yield method to determine its accruals of interest expense over the remaining term of the debt instruments in the issue.

One commentator suggested that the adjusted issue price of the combined debt instruments simply should be the sum of the issuer's adjusted issue price in the original debt instruments on the reopening date and the issue price of the additional debt instruments determined as if they were a separate issue. The final regulations do not adopt this suggestion; the rule in the proposed regulations is more accurate than the rule suggested by the commentator. The same commentator also suggested that the final regulations state that, for purposes of determining the adjusted issue price of the combined debt instruments, pre-issuance accrued interest on the additional debt instruments for which the issuer is compensated at issuance is not treated as part of the issue price of the additional debt instruments. In effect, this suggestion would make the rule in §1.1273–2(m) mandatory for debt instruments issued in a qualified reopening. Under § 1.1273–2(m), a taxpayer can choose to determine the issue price of a debt instrument by excluding pre-issuance accrued interest. There does not seem to be a compelling reason to make this rule mandatory for debt instruments issued in a qualified reopening when it is not mandatory for other debt instruments. As a result, the final regulations do not adopt this suggestion.

F. *Effective date*

The rules in the final regulations for qualified reopenings (other than for Treasury reopenings subject to §1.1275–2(d)) apply to debt instruments that are part of a reopening where the reopening date is on or after March 13, 2001.

Definition of Issue

The proposed regulations define the term issue as two or more debt instruments that (1) have the same credit and payment terms, (2) are issued either pursuant to a common plan or as part of a single transaction or a series of related transactions, and (3) are issued within a period of 13 days beginning with the date on which the first debt instrument that would be part of the issue is issued to a person other than a bond house, broker, or similar person acting in the capacity of an underwriter, placement agent, or wholesaler. The final regulations generally are the same as the proposed regulations but for the additional requirement that the debt instruments be issued on or after March 13, 2001. The final regulations also provide certain transition rules if the debt instruments are issued prior to March 13, 2001.

Issue Price of Treasury Securities

Under §1.1275–2T(d)(1), the issue price of an issue of Treasury securities auctioned before November 2, 1998, is the average price of the securities sold,

and the issue price of an issue of Treasury securities auctioned on or after November 2, 1998, is the price of the securities sold at auction. The change to the definition of issue price for Treasury securities in the temporary regulations reflected the Treasury Department's switch on November 2, 1998, from an average price auction to a single price auction for selling Treasury securities. However, in order to accommodate all types of auction techniques and because the rule for an average price auction, when applied to a single price auction, produces the same result as the rule for a single price auction, the final regulations provide that the issue price of an issue of Treasury securities is the average price of the securities sold.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of the regulations is William E. Blanchard, Office of the Associate Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

Part 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for §1.1275–2T to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.163–7 is amended by:

1. Revising paragraph (e).
2. Adding a new paragraph (f).

The revision and addition read as follows:

§1.163–7 Deduction for OID on certain debt instruments.

* * * * *

(e) *Qualified reopening*—(1) *In general*. In a qualified reopening of an issue of debt instruments, if a holder pays more or less than the adjusted issue price of the original debt instruments to acquire an additional debt instrument, the issuer treats this difference as an adjustment to the issuer's interest expense for the original and additional debt instruments. As provided by paragraphs (e)(2) through (5) of this section, the adjustment is taken into account over the term of the instrument using constant yield principles.

(2) *Positive adjustment*. If the difference is positive (that is, the holder pays more than the adjusted issue price of the original debt instrument), then, with respect to the issuer but not the holder, the difference increases the aggregate adjusted issue prices of all of the debt instruments in the issue, both original and additional.

(3) *Negative adjustment*. If the difference is negative (that is, the holder pays less than the adjusted issue price of the original debt instrument), then, with respect to the issuer but not the holder, the difference reduces the aggregate adjusted issue prices of all of the debt instruments in the issue, both original and additional.

(4) *Determination of issuer's interest accruals*. As of the reopening date, the issuer must redetermine the yield of the debt instruments in the issue for purposes of applying the constant yield method described in §1.1272–1(b) to determine the issuer's accruals of interest expense over the remaining term of the debt instruments in the issue. This redetermined yield is based on the aggregate adjusted issue prices of the debt instruments in the issue (as determined under this paragraph (e)) and the remaining payment schedule of the debt instruments in the issue. If the aggregate adjusted issue prices of the debt instruments in the issue (as determined under this paragraph (e)) are less than the aggregate stated redemption price at maturity of the instruments (determined as of the reopening date) by a *de minimis* amount (within the meaning of §1.1273–1(d)), the issuer may use the rules in paragraph (b) of this section to determine the issuer's accruals of interest expense.

(5) *Effect of adjustments on issuer's adjusted issue price*. The adjustments made under this paragraph (e) are taken into account for purposes of determining the issuer's adjusted issue price under §1.1275–1(b).

(6) *Definitions*. The terms *additional debt instrument*, *original debt instrument*, *qualified reopening*, and *reopening date* have the same meanings as in §1.1275–2(k).

(f) *Effective dates*. This section (other than paragraph (e) of this section) applies to debt instruments issued on or after April 4, 1994. Taxpayers, however, may rely on this section (other than paragraph (e) of this section) for debt instruments issued after December 21, 1992, and before April 4, 1994. Paragraph (e) of this section applies to qualified reopenings where the reopening date is on or after March 13, 2001.

Par. 3. In §1.1271-0, paragraph (b) is amended by:

1. Adding entries for paragraphs (f)(1), (f)(2), (f)(3), and (f)(4) of §1.1275–1.
2. Removing the language "[Reserved]" from the entry for paragraph (d) and adding entries for paragraph (d) of §1.1275–2.
3. Adding entries for paragraph (k) of §1.1275–2.
4. Removing the entries for §1.1275–2T.
5. Removing the language "[Reserved]" from the entry for paragraph (g) and adding an entry for paragraph (g) of §1.1275–7.

The revisions and additions read as follows:

§1.1271–0 Original issue discount; effective date; table of contents.

* * * * *

(b) * * *

* * * * *

§1.1275–1 Definitions.

* * * * *

(f) *Issue*.

(1) *Debt instruments issued on or after March 13, 2001*.

(2) *Debt instruments issued before March 13, 2001*.
(3) *Transition rule*.
(4) *Cross-references for reopening and aggregation rules*.
* * * * *

§1.1275–2 Special rules relating to debt instruments.

* * * * *
(d) *Special rules for Treasury securities*.
(1) *Issue price and issue date*.
(2) *Reopenings of Treasury securities*.
* * * * *
(k) *Reopenings*.
(1) *In general*.
(2) *Definitions*.
(3) *Qualified reopening*.
(4) *Issuer's treatment of a qualified reopening*.
(5) *Effective date*.
* * * * *

§1.1275–7 Inflation-indexed debt instruments.

* * * * *
(g) *Reopenings*.
* * * * *

Par. 4. In §1.1275–1, paragraph (f) is revised to read as follows:

§1.1275–1 Definitions.

* * * * *

(f) *Issue*—(1) *Debt instruments issued on or after March 13, 2001*. Except as provided in paragraph (f)(3) of this section, two or more debt instruments are part of the same issue if the debt instruments—

(i) Have the same credit and payment terms;

(ii) Are issued either pursuant to a common plan or as part of a single transaction or a series of related transactions;

(iii) Are issued within a period of thirteen days beginning with the date on which the first debt instrument that would be part of the issue is issued to a person other than a bond house, broker, or similar person or organization acting in the capacity of an underwriter, placement agent, or wholesaler; and

(iv) Are issued on or after March 13, 2001.

(2) *Debt instruments issued before March 13, 2001*. Except as provided in paragraph (f)(3) of this section, two or more debt instruments are part of the same issue if the debt instruments—

(i) Have the same credit and payment terms;

(ii) Are sold reasonably close in time either pursuant to a common plan or as part of a single transaction or a series of related transactions; and

(iii) Are issued on or after April 4, 1994, and before March 13, 2001.

(3) *Transition rule*. If the issue date of any of the debt instruments that would be part of the same issue (determined as if each debt instrument were part of a separate issue) is on or after March 13, 2001, then the definition of the term *issue* in paragraph (f)(1) of this section applies rather than the definition in paragraph (f)(2) of this section to determine if the debt instruments are part of the same issue.

(4) *Cross-references for reopening and aggregation rules*. See §1.1275–2(d) and (k) for rules that treat debt instruments issued in certain reopenings as part of an issue of original (outstanding) debt instruments. See §1.1275–2(c) for rules that treat two or more debt instruments as a single debt instrument.
* * * * *

Par. 5. In §1.1275–2, paragraph (d) is revised and paragraph (k) is added to read as follows:

§1.1275–2 Special rules relating to debt instruments.

* * * * *

(d) *Special rules for Treasury securities*—(1) *Issue price and issue date*. The issue price of an issue of Treasury securities is the average price of the securities sold. The issue date of an issue of Treasury securities is the first settlement date on which a substantial amount of the securities in the issue is sold. For an issue of Treasury securities sold from November 1, 1998, to March 13, 2001, the issue price of the issue is the price of the securities sold at auction.

(2) *Reopenings of Treasury securities*—(i) *Treatment of additional Treasury securities*. Notwithstanding §1.1275–1(f), additional Treasury securities issued in a qualified reopening are part of the same issue as the original Treasury securities. As a result, the additional Treasury securities have the same issue price, issue date, and (with respect to holders) the same adjusted issue price as the original Treasury securities. This paragraph (d)(2) applies to qualified reopenings that occur on or after March 25, 1992.

(ii) *Definitions*—(A) *Additional Treasury securities*. Additional Treasury securities are Treasury securities with terms that are in all respects identical to the terms of the original Treasury securities.

(B) *Original Treasury securities*. Original Treasury securities are securities comprising any issue of outstanding Treasury securities.

(C) *Qualified reopening—reopenings on or after March 13, 2001*. For a reopening of Treasury securities that occurs on or after March 13, 2001, a qualified reopening is a reopening that occurs not more than one year after the original Treasury securities were first issued to the public or, under paragraph (k)(3)(iii) of this section, a reopening in which the additional Treasury securities are issued with no more than a *de minimis* amount of OID.

(D) *Qualified reopening—reopenings before March 13, 2001*. For a reopening of Treasury securities that occurs before March 13, 2001, a qualified reopening is a reopening that occurs not more than one year after the original Treasury securities were first issued to the public. However, for a reopening of Treasury securities (other than Treasury Inflation-Indexed Securities) that occurred prior to November 5, 1999, a qualified reopening is a reopening of Treasury securities that satisfied the preceding sentence and that was intended to alleviate an acute, protracted shortage of the original Treasury securities.
* * * * *

(k) *Reopenings*—(1) *In general*. Notwithstanding §1.1275–1(f), additional debt instruments issued in a qualified reopening are part of the same issue as the original debt instruments. As a result, the additional debt instruments have the same issue date, the same issue price, and (with respect to holders) the same adjusted issue price as the original debt instruments.

(2) *Definitions*—(i) *Original debt instruments*. Original debt instruments are debt instruments comprising any single issue of outstanding debt instruments. For purposes of determining whether a particu-

lar reopening is a qualified reopening, debt instruments issued in prior qualified reopenings are treated as original debt instruments and debt instruments issued in the particular reopening are not so treated.

(ii) *Additional debt instruments*. Additional debt instruments are debt instruments that, without the application of this paragraph (k)—

(A) Are part of a single issue of debt instruments;

(B) Are not part of the same issue as the original debt instruments; and

(C) Have terms that are in all respects identical to the terms of the original debt instruments as of the reopening date.

(iii) *Reopening date*. The reopening date is the issue date of the additional debt instruments (determined without the application of this paragraph (k)).

(iv) *Announcement date*. The announcement date is the later of seven days before the date on which the price of the additional debt instruments is established or the date on which the issuer's intent to reopen a security is publicly announced through one or more media, including an announcement reported on the standard electronic news services used by security broker-dealers (for example, Reuters, Telerate, or Bloomberg).

(3) *Qualified reopening*—(i) *Definition*. A qualified reopening is a reopening of original debt instruments that is described in paragraph (k)(3)(ii) or (iii) of this section. In addition, see paragraph (d)(2) of this section to determine if a reopening of Treasury securities is a qualified reopening.

(ii) *Reopening within six months*. A reopening is described in this paragraph (k)(3)(ii) if—

(A) The original debt instruments are publicly traded (within the meaning of §1.1273–2(f));

(B) The reopening date of the additional debt instruments is not more than six months after the issue date of the original debt instruments; and

(C) On the date on which the price of the additional debt instruments is established (or, if earlier, the announcement date), the yield of the original debt instruments (based on their fair market value) is not more than 110 percent of the yield of the original debt instruments on their issue date (or, if the original debt instruments were issued with no more than a *de minimis* amount of OID, the coupon rate).

(iii) *Reopening with de minimis OID*. A reopening (including a reopening of Treasury securities) is described in this paragraph (k)(3)(iii) if—

(A) The original debt instruments are publicly traded (within the meaning of §1.1273–2(f)); and

(B) The additional debt instruments are issued with no more than a *de minimis* amount of OID (determined without the application of this paragraph (k)).

(iv) *Exceptions*. This paragraph (k)(3) does not apply to a reopening of tax-exempt obligations (as defined in section 1275(a)(3)) or contingent payment debt instruments (within the meaning of §1.1275–4).

(4) *Issuer's treatment of a qualified reopening*. See §1.163–7(e) for the issuer's treatment of the debt instruments that are part of a qualified reopening.

(5) *Effective date*. This paragraph (k) applies to debt instruments that are part of a reopening where the reopening date is on or after March 13, 2001.

§1.1275–2T [Removed]

Par. 6. Section 1.1275–2T is removed.

Par. 7. In §1.1275–7, paragraph (g) is added to read as follows:

§1.1275–7 Inflation-indexed debt instruments.

* * * * *

(g) *Reopenings*. For rules concerning a reopening of Treasury Inflation-Indexed Securities, see paragraphs (d)(2) and (k)(3)(iii) of §1.1275–2.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved December 29, 2000.

Jonathan Talisman,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 11, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 12, 2001, 66 FR 2811)

Section 1281.—Current Inclusion in Income of Discount on Certain Short-Term Obligations

The revenue procedure, which modifies section 13.02 of the Appendix to Rev. Proc. 99–49, allows any bank that uses the cash receipts and disbursements method of accounting to change automatically its method of accounting for stated interest on short-term loans made in the ordinary course of its business. See Rev. Proc. 2001–25, page 913.

Part III. Administrative, Procedural, and Miscellaneous

Repeal of the Modification of the Installment Method for Accrual Method Taxpayers

Notice 2001–22

PURPOSE

This notice provides guidance on the application of the Installment Tax Correction Act of 2000, Pub. L. No. 106-573, 114 Stat. 3061 (2000) (the "Installment Tax Correction Act"), to an accrual method taxpayer that disposed of property in an installment sale on or after December 17, 1999, and filed by April 16, 2001, a Federal income tax return reporting the gain on the disposition using an accrual method of accounting rather than the installment method.

BACKGROUND

An installment sale generally is defined in § 453(b) as a disposition of property where at least one payment is to be received after the close of the taxable year in which the disposition occurs. Section 453(a) provides the general rule that income from an installment sale must be taken into account under the installment method. However, § 536(a) of the Ticket to Work and Work Incentives Improvement Act of 1999, Pub. L. No. 106-170, 113 Stat. 1860 (1999), added former § 453(a)(2) to the Code, which provided that the installment method did not apply to income from an installment sale if the income would be reported under an accrual method of accounting without regard to § 453. Former § 453(a)(2) was effective for sales or other dispositions occurring on or after December 17, 1999, the date of enactment.

On December 28, 2000, the Installment Tax Correction Act repealed § 453(a)(2) with respect to sales and other dispositions occurring on or after December 17, 1999. Section 2(b) of the Installment Tax Correction Act provides that the Code (including § 453) should be applied and administered as if § 453(a)(2) had not been enacted.

The installment method does not apply to any disposition for which the taxpayer elects out of the installment method. Section 453(d)(1). A taxpayer that reports an amount realized equal to the selling price on the tax return filed for the taxable year in which the installment sale occurs is considered to have made an effective election out of the installment method. Section 15a.453–1(d)(3)(i) of the temporary Income Tax Regulations. An election out of the installment method with respect to a disposition may be revoked only with the consent of the Secretary. Section 453(d)(3). A revocation is retroactive. Section 15a.453–1(d)(4).

APPLICATION

Consistent with the change in law effected by the Installment Tax Correction Act, an accrual method taxpayer that entered into an installment sale on or after December 17, 1999, and filed a Federal income tax return by April 16, 2001, reporting the sale on an accrual method (and, thus, an amount realized equal to the selling price) has the consent of the Secretary to revoke its effective election out of the installment method, provided the taxpayer files, within the applicable period of limitations, amended Federal income tax return(s) for the taxable year in which the installment sale occurred, and for any other affected taxable year, reporting the gain on the installment method. Thus, a taxpayer may not revoke its effective election out of the installment method if the taxable year in which any payment on the installment obligation was received has closed.

EFFECT ON OTHER DOCUMENTS

Notice 2000–26, 2000–17 I.R.B. 954, is modified to remove Q&As 1 through 9.

DRAFTING INFORMATION

The principal author of this notice is Merrill D. Feldstein of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Ms. Feldstein at (202) 622-4950 (not a toll-free call).

Modification of Rev. Rul. 2001–4

Notice 2001–23

PURPOSE

This notice modifies Rev. Rul. 2001–4, 2001–3 I.R.B. 295, by extending the application of the automatic consent for change in accounting method provisions of Rev. Proc. 99–49, 1999–2 C.B. 725, to the taxpayer's first or second taxable year ending after December 21, 2000.

BACKGROUND

On December 21, 2000, the Internal Revenue Service issued Rev. Rul. 2001–4, which holds, in part, that costs incurred by a taxpayer to perform work on its aircraft airframe as part of a heavy maintenance visit generally are deductible as ordinary and necessary business expenses under § 162 of the Internal Revenue Code. The APPLICATION section of Rev. Rul. 2001–4 provides that a taxpayer wanting to change its method of accounting to conform to the holding must follow the automatic change in accounting method provisions of Rev. Proc. 99–49, provided the change is made for the first taxable year ending after January 16, 2001. Thus, for example, a taxpayer using a calendar year may apply for automatic consent to change its method of accounting to conform to Rev. Rul. 2001–4 for the year 2001. The Service recognizes that the revenue ruling precludes a calendar year taxpayer from applying for automatic consent for the change for the year 2000, and greatly limits its ability to apply for consent for that year under the general procedures of Rev. Proc. 97–27, 1997–1 C.B. 680, due to the requirement that the application must have been submitted by December 31, 2000.

EXTENSION OF AUTOMATIC METHOD CHANGE PROCEDURES FOR 2000

To facilitate changes in method of accounting by taxpayers to conform to the holding of Rev. Rul. 2001–4 for the year 2000, the revenue ruling is modified to allow a taxpayer to apply for the change by following the automatic change in ac-

counting method provisions of Rev. Proc. 99–49, provided the change is for the first or second taxable year ending after December 21, 2000.

If a taxpayer filed an application with the national office under Rev. Proc. 97–27 to change its method of accounting to conform to Rev. Rul. 2001–4, and the application is pending with the national office on February 16, 2001, the taxpayer may change its method under Rev. Proc. 99–49. However, the national office will process the application in accordance with the procedure under which it was filed unless, prior to the later of April 1, 2001, or the issuance of the letter ruling granting or denying consent to the change, the taxpayer notifies the national office that it wants to change its method under Rev. Proc. 99–49. If the taxpayer timely notifies the national office that it wants to change its method under Rev. Proc. 99–49, the taxpayer must make appropriate modifications to the application to comply with the applicable provisions of Rev. Proc. 99–49. In addition, any user fee that was submitted with the application will be returned to the taxpayer.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 2001–4 and Rev. Proc. 99–49 are modified.

DRAFTING INFORMATION

The principal author of this notice is Merrill Feldstein of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice contact Ms. Feldstein at (202) 622-4950 (not a toll-free call).

Differential Earnings Rate for Mutual Life Insurance Companies

Notice 2001–24

This notice publishes a tentative determination under § 809 of the Internal Revenue Code of the "differential earnings rate" for 2000 and the rate that is used to calculate the "recomputed differential earnings amount" for 1999. (The latter rate is referred to in this notice as the "recomputed differential earnings rate" for 1999.) These rates are used by mutual life insurance companies to calculate their federal income tax liability for taxable years beginning in 2000.

BACKGROUND

Section 809(a) provides that, in the case of any mutual life insurance company, the amount of the deduction allowable under § 808 for policyholder dividends is reduced (but not below zero) by the "differential earnings amount." Any excess of the differential earnings amount over the amount of the deduction allowable under § 808 is taken into account as a reduction in the closing balance of reserves under subsections (a) and (b) of § 807. The "differential earnings amount" for any taxable year is the amount equal to the product of (a) the life insurance company's average equity base for the taxable year multiplied by (b) the "differential earnings rate" for that taxable year. The "differential earnings rate" for the taxable year is the excess of (a) the "imputed earnings rate" for the taxable year over (b) the "average mutual earnings rate" for the second calendar year preceding the calendar year in which the taxable year begins. The "imputed earnings rate" for any taxable year is the amount that bears the same ratio to 16.5 percent as the "current stock earnings rate" for the taxable year bears to the "base period stock earnings rate."

Section 809(f) provides that, in the case of any mutual life insurance company, if the "recomputed differential earnings amount" for any taxable year exceeds the differential earnings amount for that taxable year, the excess is included in life insurance gross income for the succeeding taxable year. If the differential earnings amount for any taxable year exceeds the recomputed differential earnings amount for that taxable year, the excess is allowed as a life insurance deduction for the succeeding taxable year. The "recomputed differential earnings amount" for any taxable year is an amount calculated in the same manner as the differential earnings amount for that taxable year, except that the average mutual earnings rate for the calendar year in which the taxable year begins is substituted for the average mutual earnings rate for the second calendar year preceding the calendar year in which the taxable year begins.

The stock earnings rates and mutual earnings rates taken into account under § 809 generally are determined by dividing statement gain from operations by the average equity base. For this purpose, the term "statement gain from operations" means "the net gain or loss from operations required to be set forth in the annual statement, determined without regard to Federal income taxes, and ... properly adjusted for realized capital gains and losses...." *See* § 809(g)(1). The term "equity base" is defined as an amount determined in the manner prescribed by regulations equal to surplus and capital increased by the amount of nonadmitted financial assets, the excess of statutory reserves over the amount of tax reserves, the sum of certain other reserves, and 50 percent of any policyholder dividends (or other similar liability) payable in the following taxable year. *See* § 809(b)(2), (3), (4), (5) and (6). Section 1.809–10 of the Income Tax Regulations provides that the equity base includes both the asset valuation reserve and the interest maintenance reserve for taxable years ending after December 31, 1991.

Section 1.809–9(a) of the regulations provides that neither the differential earnings rate under § 809(c) nor the recomputed differential earnings rate that is used in computing the recomputed differential earnings amount under § 809(f)(3) may be less than zero.

Rev. Rul. 99–3, 1999–1 C.B. 313, provides that a life insurance subsidiary of a mutual holding company is not a mutual life insurance company for which the deduction for policyholder dividends is reduced pursuant to §§ 808(c)(2) and 809.

As described above, the differential earnings rate for 2000 and the recomputed differential earnings rate for 1999 affect the income and deductions reported by mutual life insurance companies on their federal income tax returns for the 2000 taxable year.

Data necessary to determine the tentative differential earnings rate for 2000 and the tentative recomputed differential earnings rate for 1999 have been compiled from returns filed by mutual life insurance companies and certain stock life insurance companies. The Internal Revenue Service is currently examining these returns. This examination will not be completed before the March 15, 2001, due date for filing 2000 calendar year returns.

NOTICE OF TENTATIVE RATES

This notice publishes a tentative determination of the differential earnings rate for 2000 and of the recomputed differential earnings rate for 1999. This notice also publishes a tentative determination of the rates on which the calculation of the differential earnings rate for 2000 and the recomputed differential earnings rate for 1999 are based. The final determination of these rates is expected to be published before September 1, 2001.

The tentative determination of the differential earnings rate for 2000 and the tentative determination of the recomputed differential earnings rate for 1999 that are published in this notice should be used by mutual life insurance companies to calculate the amount of tax liability for taxable years beginning in 2000 (in the case of companies that file returns before publication of the final determination of these rates) or to calculate the amount of estimated unpaid tax liability for taxable years beginning in 2000 (in the case of companies that are allowed an extension of time to file returns). Companies that file returns before publication of the final determination of these rates should file amended returns after the final determination of these rates is published. If there is a failure to pay tax for a taxable year beginning in 2000 and the failure is attributable to a difference between (a) the tentative determination of the differential earnings rate for 2000 and recomputed differential earnings rate for 1999 and (b) the final determination of these rates, then any such failure through September 17, 2001, will be treated as due to reasonable cause and will not give rise to any addition to tax under § 6651.

The tentative determination of the rates is set forth in Table 1.

Notice 2001–24 Table 1

Tentative Determination of Rates To Be Used For Taxable Years Beginning in 2000

Differential earnings rate for 2000	0
Recomputed differential earnings rate for 1999	0
Imputed earnings rate for 1999	15.815
Imputed earnings rate for 2000	15.358
Base period stock earnings rate	18.221
Current stock earnings rate for 2000	16.960
Stock earnings rate for 1997	19.321
Stock earnings rate for 1998	15.836
Stock earnings rate for 1999	15.724
Average mutual earnings rate for 1998	16.011
Average mutual earnings rate for 1999	16.164

DRAFTING INFORMATION

The principal author of this notice is Katherine A. Hossofsky of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regardingthis notice, contact Ms. Hossofsky at (202) 622-3477 (not a toll-free call).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, sections 446, 1281; 1.446–1.)

Rev. Proc. 2001–25

SECTION 1. PURPOSE

This revenue procedure modifies section 13.02 of the Appendix to Rev. Proc. 99–49, 1999–2 C.B. 725, 757, to allow any bank that uses the cash receipts and disbursements method of accounting (cash method) to change automatically its method of accounting for stated interest on short-term loans made in the ordinary course of business.

SECTION 2. BACKGROUND

.01 Rev. Proc. 99–49 provides the procedures by which a taxpayer may obtain automatic consent to change a method of accounting described in the Appendix to Rev. Proc. 99–49. Under section 13.02 of the Appendix to Rev. Proc. 99–49, a cash method bank in the Eighth Circuit can automatically change its method of accounting for stated interest on short-term loans made in the ordinary course of business from an accrual method under § 1281 of the Internal Revenue Code to the cash receipts and disbursements method of accounting. In *Security Bank Minnesota v. Commissioner*, 994 F.2d 432 (8th Cir. 1993), *aff'g* 98 T.C. 33 (1992), the U.S. Circuit Court of Appeals for the Eighth Circuit held that § 1281 does not require a cash method bank to include in gross income stated interest on short-term loans made in the ordinary course of business as that interest accrues. Because the Internal Revenue Service was litigating the § 1281 issue in other circuits, section 13.02 of the Appendix was limited to cash method banks in the Eighth Circuit.

.02 In *Security State Bank v. Commissioner*, 214 F.3d 1254 (10th Cir. 2000), *aff'g* 111 T.C. 210 (1998), *acq.*, 2001–5 I.R.B., and *U.S. Bancorp v. Commissioner*, T.C.M. 1998–381, the courts similarly held that § 1281 does not require a cash method bank to include in gross income stated interest on short-term loans made in the ordinary course of business as that interest accrues. In light of the decisions in *Security Bank Minnesota, Security State Bank*, and *U.S. Bancorp*, the Service will no longer litigate the § 1281 issue in the context of short-term loans

made in the ordinary course of a cash method bank's business. Accordingly, section 13.02 of the Appendix to Rev. Proc. 99–49 is modified to apply to all cash method banks.

SECTION 3. APPLICATION

Section 13.02 of the Appendix to Rev. Proc. 99–49 is modified to read as follows:

.02 *Stated interest on short-term loans of cash method banks*.

(1) *Description of change and scope*.

(a) *Applicability*. This change applies to a bank that uses the cash receipts and disbursements method of accounting as its overall accounting method and that wants to change its method of accounting from accruing stated interest on short-term loans made in the ordinary course of business to using the cash method for that interest. For example, see *Security State Bank v. Commissioner*, 214 F.3d 1254 (10th Cir. 2000), *aff'g* 111 T.C. 210 (1998), *acq.*, 2001–5 I.R.B., and *Security Bank Minnesota v. Commissioner*, 994 F.2d 432 (8th Cir. 1993), *aff'g* 98 T.C. 33 (1992), in which the courts held that § 1281 does not apply to short-term loans made by a cash method bank in the ordinary course of its business.

(b) *Scope limitations inapplicable*. A taxpayer that wants to make this change is not subject to the scope limitations in section 4.02 of this revenue procedure. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

(2) *Change for prior taxable years*. A taxpayer is permitted to make the change in accounting method described in section 13.02(1)(a) of this Appendix for any taxable year ending before December 31, 2000, provided the year is not barred by the statute of limitations, there is no closed taxable year after the year of change, and the taxpayer complies with the following requirements:

(a) the taxpayer must attach a completed Form 3115 to an amended return for the year of change, and must file, on or before December 31, 2001, that amended return and amended returns for all subsequent affected taxable years, if any; and

(b) the taxpayer must file a copy of the Form 3115 with the national office no later than when the original Form 3115 is filed with the amended return.

(3) *Section 481(a) adjustment period*. A taxpayer making this change must take the entire § 481(a) adjustment into account in computing taxable income for the year of change.

SECTION 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 99–49 is modified.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective on February 20, 2001.

DRAFTING INFORMATION

The principal author of this revenue procedure is William E. Blanchard of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure, contact either Mr. Blanchard or Marsha A. Sabin of the Office of the Associate Chief Counsel (Financial Institutions and Products) at (202) 622–3950 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Interest-Free Adjustments with Respect to Underpayments of Employment Taxes

REG–110374–00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains a proposed amendment to the regulations relating to interest-free adjustments with respect to underpayments of employment taxes. The proposed amendment reflects changes to the law made by the Taxpayer Relief Act of 1997. The proposed amendment affects employers that are the subject of IRS examinations involving determinations by the IRS that workers are employees for purposes of subtitle C or that the employers are not entitled to relief from employment taxes under section 530 of the Revenue Act of 1978 (section 530).

DATES: Written and electronic comments and requests for a public hearing must be received by April 17, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–110374–00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: Unit CC:M&SP:RU (REG–110374–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at *http://www.irs.gov/tax_regs/reglist.html.*

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Lynne Camillo of the Office of Associate Chief Counsel (Tax Exempt and Government Entities), (202) 622-6040.

SUPPLEMENTARY INFORMATION:

Background

This document contains a proposed amendment to the Employment Tax Regulations (26 CFR part 31) under section 6205. Section 6205 allows employers that have paid less than the correct amount of employment taxes to make adjustments without interest, provided the error is reported and the taxes are paid by the last day for filing the return for the quarter in which the error was ascertained. However, no interest-free adjustments are permitted pursuant to section 6205 after receipt of notice and demand for payment thereof based upon an assessment. §31.6205–1(a)(6).

The Taxpayer Relief Act of 1997, Public Law 105-34 (111 Stat. 788), effective August 5, 1997, created new section 7436 of the Internal Revenue Code (Code), which provides the Tax Court with jurisdiction to review determinations by the IRS that workers are employees for purposes of subtitle C, or that the employer is not entitled to relief from employment taxes under section 530. Section 7436 resulted in a change in the way employment tax examinations involving worker classification and section 530 issues are conducted insofar as notice and demand for payment of an employment tax underpayment based upon an assessment cannot be made until after the taxpayer under examination receives notice of the IRS's determination and has been given an opportunity to file a petition in the Tax Court contesting such determination.

Explanation of Provisions

This document contains a proposed amendment to the regulations under section 6205. The proposed amendment clarifies the period for adjustments of employment tax underpayments without interest under section 6205 following the expansion of Tax Court review to certain employment tax determinations.

As a general rule, under section 6601, all taxpayers who fail to pay the full amount of a tax due under the Code must pay interest at the applicable rate on the unpaid amount from the last date prescribed for payment of the tax until the date the tax is paid. However, section 6205 allows employers that have paid less than the correct amount of certain employment taxes[1] with respect to any payment of wages or compensation to make adjustments to returns without interest pursuant to the regulations. The employment tax regulations under section 6205 generally allow employers to make adjustments to returns without interest until the last day for filing the return for the quarter in which the error was ascertained. An error is ascertained when the employer has sufficient knowledge of the error to be able to correct it. §31.6205–1(a)(4). Section 31.6205–1(a)(6) provides that no interest-free adjustments can be made after receipt of a statement of notice and demand for payment based upon an assessment.

In Revenue Ruling 75–464 (1975–2 C.B. 474), the IRS further clarified the time for adjustments under section 6205. The ruling clarifies that employers can still make interest-free adjustments where the underpayment is discovered during an audit or examination (i.e., where the employer has not independently ascertained the underpayment). The ruling sets forth situations illustrating when an error is ascertained with respect to returns under audit by the IRS. Under the facts in the revenue ruling, an error is ascertained when the employer signs an "Agreement to Adjustment and Collection of Additional Tax," Form 2504, either at the examination level or the appeals level, when the taxpayer pays the full amount due so as to file a refund claim (if paid prior to notice and demand), or at the conclusion of internal IRS appeal rights if no agreement is reached. Under the factual situations in Revenue Ruling 75–464, the employment taxes can be paid free of interest at the time the employer signs Agreement Form 2504 or at the time it pays the tax preparatory to filing a claim to contest the liability in court, after having exhausted all appeal rights within the IRS, provided

[1] Section 6205 applies to underpayments of taxes under the Federal Insurance Contributions Act (FICA), the Railroad Retirement Tax Act (RRTA), and income tax withholding. Section 6205 does not apply to underpayments of taxes under Federal Unemployment Tax Act (FUTA), as such underpayments are not subject to interest under section 6601(i).

the payment is made before the taxpayer receives notice and demand for payment.

The Taxpayer Relief Act of 1997, Public Law 105-34 (111 Stat. 788), created new section 7436 of the Code which provides the Tax Court with jurisdiction to review determinations by the IRS that workers are employees for purposes of subtitle C of the Code, or that the organization for which services are performed is not entitled to relief from employment taxes under section 530. Section 7436(a) requires that the determination involve an actual controversy and that it be made as part of an examination. Subsequent to enactment of section 7436 of the Code, the IRS created a standard notice, the "Notice of Determination Concerning Worker Classification Under Section 7436" (notice of determination) to serve as the "determination" that is a prerequisite to invoking the Tax Court's jurisdiction under section 7436. Notice 98–43 (1998–33 I.R.B. 13).

Section 7436(d)(1) provides that the suspension of the limitations period for assessment in section 6503(a) applies in the same manner as if a notice of deficiency had been issued. Thus, pursuant to section 6503(a), the mailing of the notice of determination by certified or registered mail will suspend the statute of limitations for assessment of taxes attributable to the worker classification and section 530 issues. Generally, the statute of limitations for assessment of taxes attributable to the worker classification and section 530 issues is suspended for the 90-day period during which the taxpayer can begin a suit in Tax Court, plus an additional 60 days thereafter. Moreover, if the taxpayer does file a timely petition in the Tax Court, the statute of limitations for assessment of taxes attributable to the worker classification and section 530 issues is suspended under section 6503(a) during the Tax Court proceedings, and for sixty days after the Tax Court decision becomes final.

Current IRS guidance provides for interest-free adjustments under section 6205 prior to assessment and notice and demand. Because of the prohibition on assessment for cases pending in the Tax Court, this creates a potential for inconsistent application of interest depending upon whether an employer files a claim in the Tax Court or in another court of Federal jurisdiction. The legislative history of section 7436 shows no intent to create an advantage for taxpayers who choose to litigate their cases in Tax Court as opposed to another court of Federal jurisdiction. H.R. No. 105-148, 105th Cong., 1st Sess., at 639-640 (1997). Taxpayers who choose to petition the Tax Court under section 7436 still have the benefit of all of the inherent advantages of litigating in the Tax Court, including the ability to obtain judicial review without prior payment of the additional tax the IRS has determined to be due.

Judicial and administrative precedents provide that an error is ascertained for purposes of section 6205 (ending the period for interest-free adjustments) when the taxpayer has exhausted all internal appeal rights with the Service. *Eastern Investment Corp. v. United States*, 49 F.3d 651 (10th Cir. 1995); Rev. Rul. 75–464 (1975–2 C.B. 474). In the context of refund litigation, where a taxpayer whose erroneous underpayment of employment taxes is discovered during an examination pays only the required divisible portion of employment tax prior to filing a claim for refund in order to satisfy the jurisdictional requirements for filing suit in district court, interest continues to accrue on the unpaid portion of employment tax from the date upon which the tax is assessed after the taxpayer has exhausted all appeal rights within the IRS until the date such tax is paid. *See Eastern Investment Corp., supra* (rejecting taxpayer's argument that the error could not have been "ascertained" until a decision was made by the court and the liability was no longer being contested). Moreover, in Tax Court deficiency proceedings that do not involve employment taxes, unless the taxpayer makes a deposit to stop the running of interest, interest continues to accrue on the deficiency during the course of the Tax Court proceeding. Rev. Rul. 56–501 (1956–2 C.B. 954).

In employment tax examinations that do not involve worker classification or section 530 issues, the taxpayer has exhausted all internal appeal rights by the time a notice and demand for payment thereof based upon an assessment is received. Similarly, in employment tax examinations involving worker classification or section 530 issues, the taxpayer has already had the benefit of all of the same internal appeal rights by the time a notice of determination is received.

These proposed regulations provide that, in employment tax examinations involving worker classification or section 530 issues, as in other types of employment tax examinations, the error is ascertained for purposes of section 6205 when the employer has exhausted all internal appeals within the IRS. The fact that notice and demand for payment based upon an assessment cannot be made in cases involving worker classification and section 530 issues until the suspension of the statute of limitations is lifted, following issuance of a notice of determination, does not result in an extension of the period during which interest-free adjustments can be made under section 6205. Accordingly, in order to clarify that the error is ascertained for purposes of section 6205 once a taxpayer has exhausted all internal appeal rights with the IRS, the existing regulations would be modified by prohibiting interest-free adjustments after receipt of the notice of determination.

However, if, prior to receipt of a notice of determination, a taxpayer makes a remittance which is equal to the amount of the proposed liability, the IRS considers the remittance a payment and assesses it. Rev. Proc. 84–58 (1984–2 C.B. 501). In such a situation, no notice of determination would be sent to the taxpayer. If a taxpayer wants to stop the running of interest and contest the adjustment in the Tax Court, the taxpayer may make a remittance, designating it in writing as a deposit in the nature of a cash bond. If the taxpayer makes such a deposit, the IRS does not consider the remittance a payment. Id. at §4.02. The deposit stops the running of interest and, if the taxpayer does not waive the restrictions on assessment, the IRS will send the taxpayer a notice of determination, thus permitting the taxpayer the option of Tax Court review.

In order to provide a mechanism for taxpayers to make a remittance to stop the accrual of interest, yet still receive a notice of determination and retain the right to petition the Tax Court, these proposed regulations would further modify the existing regulations to provide that, prior to receipt of a notice of determination, the taxpayer may, in lieu of making a payment, make a cash bond deposit which would have the effect of stopping the ac-

crual of any interest, but would not deprive the taxpayer of its right to receive a notice of determination and to petition the Tax Court under section 7436.

Proposed Effective Date

These regulations are proposed to be applicable with respect to notices of determination issued on or after March 19, 2001. Interest will be computed under the rule in this regulation on any claims for refund of interest pending on January 17, 2001. No inference is intended that the rule set forth in these proposed regulations is not current law. Taxpayers may rely on these proposed regulations for guidance pending the issuance of final regulations. If, and to the extent, future guidance is more restrictive than the guidance in the proposed regulations, the future guidance will be applied without retroactive effect.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic and written comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the Federal Register.

Drafting Information

The principal author of these proposed regulations is Lynne Camillo, Office of the Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 31 is proposed to be amended as follows:

PART 31 — EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT THE SOURCE

Paragraph 1. The authority for part 31 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. In §31.6205–1, paragraph (a)(6) is revised to read as follows:

§31.6205–1 Adjustments of underpayments.

(a) * * *

(6) No underpayment shall be reported pursuant to this section after the earlier of the following—

(i) Receipt from the Commissioner of notice and demand for payment thereof based upon an assessment; or

(ii) Receipt from the Commissioner of a Notice of Determination Concerning Worker Classification Under Section 7436 (Notice of Determination). (Prior to receipt of a Notice of Determination, the taxpayer may, in lieu of making a payment, make a cash bond deposit which would have the effect of stopping the accrual of any interest, but would not deprive the taxpayer of its right to receive a Notice of Determination and to petition the Tax Court under section 7436).

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 16, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 17, 2001, 66 F.R. 3956)

Notice of Proposed Rulemaking

Amendment, Check the Box Regulations

REG–110659–00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance relating to elective changes in entity classification. The proposed regulations apply to subsidiary corporations that elect to change their classification for Federal tax purposes from a corporation to either a partnership or disregarded entity.

DATES: Written or electronic comments, or requests for a public hearing must be received by February 2, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–110659–00), room 5226, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG–110659–00), Courier's desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/tax_regs/regslist.html.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, David J. Sotos, (202) 622-3050; concerning submissions of comments, or to request a hearing, Sonya Cruse, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

On November 29, 1999, Treasury and the IRS published final regulations (T.D. 8844, 1999–2 C.B. 661) describing the transactions that are deemed to occur when an entity elects to change its classification for Federal tax purposes. Those regulations did not address certain re-

quirements of section 332 as applied to the deemed liquidation incident to an association's election to be classified as a partnership or to be disregarded as an entity separate from its owner. This amendment to the final regulations addresses those requirements.

On January 20, 2000, Treasury and the IRS issued final regulations relating to qualified subchapter S subsidiaries. In order to permit the deemed transaction resulting from a QSub election to comply with the requirement of section 332 that a plan of liquidation have been adopted at the time of a liquidating distribution, the final regulations provide that a plan of liquidation is deemed adopted immediately before the deemed liquidation incident to the QSub election, unless a formal plan of liquidation that contemplates the filing of a QSub election is adopted on an earlier date. The preamble to the QSub regulations provided that Treasury and the IRS intend to amend the section 7701 regulations regarding elective changes in entity classification to provide a similar rule concerning the timing of the plan of liquidation.

Explanation of Provisions

A. *In General*

Section 301.7701–3(g)(1) describes how elective changes in the classification of an entity will be treated for tax purposes. Section 301.7701–3(g)(1)(ii) provides that an elective conversion of an association to a partnership is deemed to have the following form: the association distributes all of its assets and liabilities to its shareholders in liquidation of the association, and immediately thereafter, the shareholders contribute all of the distributed assets and liabilities to a newly formed partnership. Section 301.7701–3(g)(1)(iii) provides that an elective conversion of an association to an entity that is disregarded as an entity separate from its owner is deemed to have the following form: the association distributes all of its assets and liabilities to its single owner in liquidation of the association.

Section 332 may be relevant to the deemed liquidation of an association if it has a corporate owner. Under section 332, no gain or loss is recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation if the requirements of section 332(b) are satisfied. Those requirements include the adoption of a plan of liquidation at a time when the corporation receiving the distribution owns stock of the liquidating corporation meeting the requirements of section 1504(a)(2) (i.e., 80 percent of vote and value). The elective changes from association to a partnership and to a disregarded entity result in a constructive liquidation of the association for Federal tax purposes. Formally adopting a plan of liquidation for the entity, however, is potentially incompatible with an elective change under §301.7701–3, which allows the local law entity to remain in existence while liquidating only for Federal tax purposes. Accordingly, to provide tax treatment of an association's deemed liquidation that is compatible with the requirements of section 332, the proposed regulations state that, for purposes of satisfying the requirement of adoption of a plan of liquidation under section 332(b), a plan of liquidation is deemed adopted immediately before the deemed liquidation incident to an elective change in entity classification, unless a formal plan of liquidation that contemplates the filing of the elective change in entity classification is adopted on an earlier date.

B. *Proposed Effective Dates*

These regulations are proposed to apply to elections occurring on or after the date final regulations are published in the **Federal Register**; however, it is also proposed that taxpayers may elect to apply the amendments retroactively.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. It also has been determined that section 533(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet Site at *http://www.irs.ustreas.gov/tax_regs/comments.html*. All comments will be available for public inspection and copying. The Treasury Department and IRS specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these proposed regulations are David J. Sotos, and Jeanne M. Sullivan of Associate Chief Counsel (Passthroughs & Special Industries). However, other personnel from the Treasury Department and IRS participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

PART 301–PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 301.7701–3 is amended as follows:

1. Redesignating the text of paragraph (g)(2) as paragraph (g)(2)(i) and adding a heading for paragraph (g)(2)(i).

2. Adding a new paragraph (g)(2)(ii).

3. Revising the first sentence of paragraph (g)(4).

The addition and revision read as follows:

§301.7701–3 Classification of certain business entities.

* * * * *

(g) * * *

* * * * *

(2) *Effect of elective changes*—(i) *In general.* * * *

(ii) *Adoption of plan of liquidation.* For purposes of satisfying the requirement of adoption of a plan of liquidation under section 332, unless a formal plan of liquidation that contemplates the election to be classified as a partnership or to be disregarded as an entity separate from its owner is adopted on an earlier date, the making, by an association, of an election under paragraph (c)(1)(i) of this section to be classified as a partnership or to be disregarded as an entity separate from its owner is considered to be the adoption of a plan of liquidation immediately before the deemed liquidation described in paragraph (g)(1)(ii) or (iii) of this section. This paragraph (g)(2)(ii) applies to elections effective on or after the date these regulations are published as final regulations in the **Federal Register**. Taxpayers may apply this paragraph (g)(2)(ii) retroactively to elections filed before these regulations are published as final regulations in the **Federal Register** if the corporate owner claiming treatment under section 332 and its subsidiary making the election take consistent positions with respect to the Federal tax consequences of the election.

* * * * *

(4) *Effective date.* Except as otherwise provided in paragraph (g)(2)(ii) of this section, this paragraph (g) applies to elections that are filed on or after November 29, 1999.***

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 16, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 17, 2001, 66 F.R. 3959)

Notice of Proposed Rulemaking and Notice of Public Hearing

Debt Instruments With Original Issue Discount; Annuity Contracts

REG–125237–00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the federal income tax treatment of annuity contracts issued by certain insurance companies. These proposed regulations provide guidance on whether certain annuity contracts are excluded from the definition of a debt instrument under the original issue discount provisions of the Internal Revenue Code. This document also provides a notice of public hearing on the proposed regulations.

DATES: Written or electronically generated comments must be received by April 12, 2001. Requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for May 30, 2001, at 10 a.m. must be submitted by May 9, 2001.

ADDRESSES: Send submission to: CC:M&SP:RU (REG–125237–00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG–125237–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS internet site at *http://www.irs.gov/tax_regs/regslist.html*. The public hearing will be held in room 4718, 1111 Constitution Ave., NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Patrick E. White, (202) 622-3920; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, contact LaNita VanDyke, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Sections 163(e) and 1271 through 1275 of the Internal Revenue Code (Code) provide rules for the treatment of debt instruments with original issue discount (OID). Section 1275(a)(1)(A) defines the term "debt instrument" to include a bond, debenture, note or certificate or other evidence of indebtedness. Sections 1275(a)(1)(B)(i) and (ii), however, exclude certain annuity contracts from the definition of a debt instrument.

On February 2, 1994, the IRS and Treasury published in the **Federal Register** (59 FR 4799) final regulations concerning a variety of issues under the OID provisions. On January 8, 1998, the IRS and Treasury published in the **Federal Register** (63 FR 1054) final regulations concerning the life annuity exception of section 1275(a)(1)(B)(i). This document contains proposed rules concerning the exception for annuities described in section 1275(a)(1)(B)(ii).

Explanation of Provisions

In general, the OID provisions apply to issuers and holders of debt instruments. The term debt instrument generally means any instrument or contractual arrangement that constitutes indebtedness under general principles of income tax law. See section 1275(a)(1)(A) and §1.1275–1(d).

If a contract is a debt instrument with OID, section 1272 generally requires the holder of the contract to include OID in income currently on a constant yield basis, regardless of the holder's overall method of accounting. By contrast, the holder of an annuity contract to which section 72 applies generally is allowed to defer recognizing economically earned income until distributions are made on the contract.

Section 1275(a)(1)(B) excepts two types of annuity contracts from the definition of a debt instrument. First, section 1275(a)(1)(B)(i) excepts an annuity contract to which section 72 applies if the contract "depends (in whole or in substantial part) on the life expectancy of 1 or more individuals." Second, section 1275(a)(1)(B)(ii) excepts an annuity con-

tract to which section 72 applies under certain circumstances if the contract "is issued by an insurance company subject to tax under subchapter L (or by an entity described in section 501(c) and exempt from tax under section 501(a) which would be subject to tax under subchapter L were it not so exempt)."

The legislative history of section 1275(a)(1)(B)(ii) is limited. This exception to the OID rules first appeared when the bill emerged from the Conference Committee in 1984. H.R. 4170, 98th Cong., 2d Sess. § 41 (1984). At that time, section 1275(a)(1)(B)(ii) applied to certain annuity contracts issued by an insurance company subject to tax under subchapter L. The 1984 Conference Report does not elaborate on the meaning of the phrase "an insurance company subject to tax under subchapter L," nor does it explain the purpose of the provision. H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 802–05 (1984), 1984–3 (Vol. 2) C.B. 56–59. In 2000, a technical correction to section 1275(a)(1)(B)(ii) was enacted. The technical correction clarified that section 1275(a)(1)(B)(ii) also applied to annuity contracts issued by "an entity described in section 501(c) and exempt from tax under section 501(a) which would be subject to tax under subchapter L were it not so exempt." Consolidated Appropriations Act, 2001, Public Law 106–554 (114 Stat. 2763).

In 1998, the IRS and Treasury promulgated §1.1275–1(j), interpreting the life annuity exception of section 1275(a)(1)(B)(i). Commentators had also requested guidance on the scope of the section 1275(a)(1)(B)(ii) exception, particularly with regard to foreign insurers not engaged in a trade or business in the U.S.

The proposed regulations provide that an annuity contract issued by a foreign insurance company is treated as issued by an insurance company subject to tax under subchapter L if the insurance company is subject to tax under subchapter L with respect to income earned on the annuity contract. The IRS and Treasury believe that this is the most natural application of the language of section 1275(a)(1)(B)(ii) and is consistent with the use of that phrase elsewhere in the Code and regulations. See, e.g., sections 953(e)(3)(C) and 1297(b)(2)(B); §1.848–2(h). The IRS and Treasury also believe that the exception from the OID rules was intended to preserve a balance between the tax treatment of holders of annuity contracts under section 72 and the tax treatment of issuers of such contracts. This balance does not exist when the annuity contract is issued by a foreign person that is not required to calculate its income with respect to the contract under subchapter L.

Proposed Effective Date

The proposed regulations are proposed to apply for interest accruals on or after the date that is 30 days after final regulations are published in the **Federal Register** on annuity contracts held on or after that date. The regulations will not apply to an annuity contract that was purchased before January 12, 2001. Special rules are provided for additional investments after January 12, 2001, with respect to an annuity contract held as of that date. This effective date framework is similar to that provided in §1.1275–1(j)(8) with respect to the life annuity exception of section 1275(a)(1)(B)(i).

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (a signed original and eight (8) copies of written comments) that are submitted timely (in the manner described in the "ADDRESSES" portion of this preamble) to the IRS. The IRS and Treasury request comments on the clarity of the proposed rules and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for May 30, 2001, beginning at 10 a.m. in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see "FOR FURTHER INFORMATION CONTACT."

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments and an outline of topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by May 9, 2001. A period of 10 minutes will be allotted to each person making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Patrick E. White, Office of the Associate Chief Counsel (Financial Institutions & Products). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.1271–0 is amended by adding entries for paragraphs (k) through (k)(3) to §1.1275–1 to read as follows:

§1.1271–0 Original issue discount; effective dates; table of contents.

* * * * *

§1.1275–1 Definitions.

* * * * *

(k) Exception under section 1275(a)(1)(B)(ii) for annuities issued by an insurance company subject to tax under subchapter L .
(1) Rule.
(2) Examples.
(3) Effective date.

* * * * *

Par. 3. Section 1.1275–1 is amended by adding paragraph (k) to read as follows:

§1.1275–1 Definitions.

* * * * *

(k) *Exception under section 1275(a)(1)(B)(ii) for annuities issued by an insurance company subject to tax under subchapter L*—(1) *Rule*. For purposes of section 1275(a)(1)(B)(ii), an annuity contract issued by a foreign insurance company is considered as issued by an insurance company subject to tax under subchapter L if the insurance company is subject to tax under subchapter L with respect to income earned on the annuity contract.

(2) *Examples*. The following examples illustrate the rule of paragraph (k)(1) of this section. Each example assumes that the annuity contract is a contract to which section 72 applies and was issued in a transaction where there is no consideration other than cash or another qualifying annuity contract, pursuant to the exercise of an election under an insurance contract by a beneficiary thereof on the death of the insured party, or in a transaction involving a qualified pension or employee benefit plan. The examples are as follows:

Example 1. Company X is an insurance company that is organized, licensed and doing business in Country Y. Company X does not have a U.S. trade or business and is not, under section 842, subject to U.S. income tax under subchapter L with respect to income earned on annuity contracts. A, a U.S. taxpayer, purchases an annuity contract from Company X in Country Y. The annuity contract is not excepted from the definition of a debt instrument by section 1275(a)(1)(B)(ii).

Example 2. The facts are the same as in *Example 1*, except that Company X has a U.S. trade or business. A purchased the annuity from Company X's U.S. trade or business. Under section 842(a), Company X is subject to tax under subchapter L with respect to income earned on the annuity contract. Under these facts, the annuity contract is excepted from the definition of a debt instrument by section 1275(a)(1)(B)(ii).

Example 3. The facts are the same as in *Example 2*, except that there is a tax treaty between Country Y and the United States. Company X is a resident of Country Y for purposes of the U.S.-Country Y tax treaty. Company X's activities in the U.S. do not constitute a permanent establishment under the U.S.-Country Y tax treaty. Because Company X does not have a U.S. permanent establishment, Company X is not subject to tax under subchapter L with respect to income earned on the annuity contract. Thus, the annuity contract is not excepted from the definition of a debt instrument by section 1275(a)(1)(B)(ii).

Example 4. The facts are the same as in *Example 1*, except that Company X is a foreign insurance corporation controlled by a U.S. shareholder. Company X does not make an election under section 953(d) to be treated as a domestic corporation. The controlling U.S. shareholder is required under sections 953 and 954 to include income earned on the annuity contract in its taxable income under subpart F. However, Company X is not subject to tax under subchapter L with respect to income earned on the annuity contract. Thus, the annuity contract is not excepted from the definition of a debt instrument by section 1275(a)(1)(B)(ii).

Example 5. The facts are the same as in *Example 4*, except that Company X properly elects under section 953(d) to be treated as a domestic corporation. By reason of its election, Company X is subject to tax under subchapter L with respect to income earned on the annuity contract. Thus, the annuity contract is excepted from the definition of a debt instrument by section 1275(a)(1)(B)(ii).

(3) *Effective date*. This paragraph (k) is applicable for interest accruals on or after the date that is 30 days after final regulations are published in the **Federal Register**. This paragraph (k) does not apply to an annuity contract that was purchased before January 12, 2001. For purposes of this paragraph (k), if any additional investment in a contract purchased before January 12, 2001, is made on or after January 12, 2001, and the additional investment is not required to be made under a binding written contractual obligation that was entered into before that date, then the additional investment is treated as the purchase of a contract after January 12, 2001.

David A. Mader,
Acting Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 11, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 12, 2001, 66 F.R. 2852)

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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